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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 614

VALLEY WASTE MILLS,

Petitioner,

vs.

W. E. PAGE, JR., AND FIRST NATIONAL BANK OF ATLANTA, EXECUTORS OF THE ESTATE OF W. E. PAGE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

HATTON LOVEJOY,
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LOUIS REGENSTEIN, JR.,
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STATUTES CITED.

Revenue Act of 1938, Section 118 A 11
28 U. S. C. A. 347 4

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PETITION FOR WRIT OF CERTIORARI.

The above named petitioner respectfully prays that writ of certiorari be granted to review and reverse a judgment of the Circuit Court of Appeals of the Fifth Circuit wherein petitioner was appellant and respondents were appellees, being case No. 9555 in the said United States Circuit Court of Appeals for the Fifth Circuit, which judgment affirmed a judgment of the District Court of the United States for the Middle District of Georgia, adverse to petitioner. The judgment of the Circuit Court of Appeals was rendered November 5, 1940. Petitioner files herewith ten copies of the record as printed in the court below, together with the proceedings and opinion in that court.

Summary Statement of Matter Involved.

In the District Court petitioner instituted this suit against the executors of the deceased collector of Internal Revenue of the United States for the District of Georgia, to collect a certain amount alleged to have been an over payment of income taxes for the year 1933. The case was submitted to the District Court on an agreed statement of facts, without the intervention of a jury. The District Judge entered a judgment denying a recovery. This judgment has been affirmed by the Circuit Court of Appeals of the Fifth Circuit.

Under the agreed statement of facts the case turned entirely on whether petitioner received taxable income as a result of certain transactions in the year 1933. If these transactions resulted in taxable income petitioner was not entitled to recover. If they did not result in taxable income petitioner was entitled to recover the amount involved in the suit.

The several transactions are all of the same nature and involve transactions on the cotton exchanges known in the trade as "switching" transactions. The facts and circumstances are as follows:

At the commencement of the year 1933 petitioner held contracts for the purchase by it of a certain amount of cotton of a certain grade for future delivery. In the language of the trade petitioner was "long" this amount of cotton. At the commencement of that year petitioner's board of directors passed a resolution directing that its officers maintain its "long" position in the cotton market to this extent. This is important because it is a material factor in dealing with the legal problems arising in this case that the simultaneous purchases and sales that thereafter occurred were each and all pursuant to a definite

predetermined plan to maintain and not to change the position of petitioner in the cotton market.

Under the rules of the New York and New Orleans cotton exchanges all contracts for the future purchase of cotton mature within twelve months and cannot technically be extended. A practice has developed on these exchanges, however, to effect the same result by simultaneously selling the cotton called for in a maturing contract and entering into another contract at the same time for the purchase of an equal number of bales of cotton of the same grade to be delivered at a later date. As the Circuit Court of Appeals in its judgment points out this in the trade is spoken of as "buying a contract" and "selling a contract", but actually the customer is himself a party to the contract. He does not buy a contract but makes a contract. He sells cotton and at the same time buys the same grade of cotton in the same amount for a later delivery. His position from an economic standpoint remains wholly unchanged.

In calculating the tax against petitioner the Commissioner of Internal Revenue treated the two elements entering into each "switching" transaction—that is—the sale of one lot of cotton and the purchase of an equal lot of cotton, as wholly separate and distinct transactions and charged the petitioner with taxable gains on each such sale. Petitioner's contention was and is that as the purchase and sale were made simultaneously, pursuant to a predetermined plan to maintain petitioner's position unaltered, the switching transaction should be regarded as producing neither gain nor loss, but that the determination of gain or loss should be made when each lot of cotton was finally closed out and petitioner's market position thus altered.

Jurisdiction.

The Court has jurisdiction to issue the writ of certiorari to review the decision of the United States Circuit of Ap-

peals for the Fifth Circuit herein under Section 270 of the Judicial Code as amended by the Acts of February 13, 1925 (Title 28, U. S. C. A. Section 347).

The Questions Presented.

As above indicated the question here presented is whether the simultaneous sale and purchase of cotton under the circumstances above stated, when made pursuant to the predetermined plan above stated, should be regarded as effecting a taxable gain or loss on the particular sales; or whether on the contrary the Court should consider such switching transactions as effecting neither gain nor loss, but merely preserving the taxpayer's economic status exactly as it had been pursuant to the predetermined plan to maintain such status.

The question may be stated a little differently as follows:

Where there is a purchase and sale of a certain commodity made simultaneously pursuant to a predetermined plan to maintain the taxpayer's position unaltered with respect to that commodity, does taxable gain or loss arise?

It may be stated fundamentally in still a different way: Where a commodity is bought and sold simultaneously in the same amount and of the same grade pursuant to a predetermined plan to maintain the taxpayer's position unaltered, and where the transactions thus had do in fact carry out the plan and maintain the taxpayer's economic position substantially unaltered, will the Court, in applying the tax laws of the United States be governed by the substance of the matter as thus disclosed, or on the other hand, will it disregard the substance and determine the question of gain or loss narrowly from the technical form which the transactions took? Attention should here be directed to the fact that the technical form of these particular transactions was due, not to a preference on the

part of the taxpayer to follow these forms, but to the fortuitous circumstance that it was the form for such transactions provided by the exchanges involved.

Specification of Errors Complained of.

The decision of the Circuit Court of Appeals presents the following basic errors which are herein specified:

1. The Circuit Court of Appeals erred in holding that where a commodity is sold and contemporaneously an equal amount of the same commodity of the same grade is purchased pursuant to a predetermined plan to retain the same economic position, the sale would be treated as a closed transaction, realizing gain or loss to the taxpayer, and the purchase would be treated as commencing a new transaction.

2. The Circuit Court of Appeals erred in treating the tax liability of a taxpayer, growing out of situations of the kind just described, as being controlled by the form in which the transactions happened to be cast, rather than by the economic realities of the situation.

Reasons Relied On for the Allowance of the Writ.

It is respectfully submitted that the writ should be granted for the following reasons:

1. It is a matter of general importance as to how the tax laws of the United States should be applied in such a situation. The purchase and sale of commodities simultaneously for the purpose of maintaining an unaltered position in the market is something that must have occurred with substantial frequency in this country. Frequently, also, this will be the result of a predetermined plan to maintain an unaltered economic position on the part of the taxpayer. It is a matter of great public importance to settle definitely

the taxable effect of such transactions. It should in this connection be borne in mind that the plan applied to this taxpayer may in many instances have the effect of reducing a tax liability instead of increasing it. It so happens that in the present matter the plan followed by the Commissioner of Internal Revenue increased the tax liability of this taxpayer; but if the forms of such transactions are to govern the question of gains, they will equally control the question of losses, and in the long run such a rule would reduce the tax revenue of the Government as frequently as it would increase it. It is, however, a matter of general public importance that the matter should be settled definitely and finally by this Court. While we believe that the principles which should apply have been definitely settled by this Court, and that the decision of the Circuit Court of Appeals is in conflict with these decisions, nevertheless, there is, on the facts, no decision of this Court specifically controlling.

2. The decision of the United States Circuit Court of Appeals is in conflict with repeated rulings of this Court that in tax matters substance and not form should prevail. The decision is in principle in conflict with applicable decisions of this Court in this respect, particularly the following:

Pearson v. *McGraw*, 308 U. S. 313;
Helvering v. *Clifford*, 309 U. S. 331;
Higgins v. *Smith*, 308 U. S. 473;
Griffith v. *Helvering*, 308 U. S. 355;
Bowers v. *Kerbaugh Empire Co.*, 271 U. S. 170;

and see

Southern Pac. Co. v. *Lowe*, 247 U. S. 330;
United States v. *Phellis*, 257 U. S. 156;
Gulf Oil Corp. v. *Lewellyn*, 248 U. S. 71;
Eisner v. *Macomber*, 252 U. S. 189.

It is not contended that the facts in these cases are the same as in the case at bar, but it is contended that the principle announced by them as herein stated is directly and inevitably in conflict with the result reached by the United States Circuit Court of Appeals in the present case.

3. The decision of the Circuit Court of Appeals is in conflict with decisions of other Circuit Courts of Appeal involving the same principle. Particularly, it is in conflict with the following:

Commissioner v. *Dyer*, 74 F. (2d) 685 (C. C. A. 2nd);
Foster v. *Commissioner*, 96 F. (2d) 130 (C. C. A. 2nd);
Schoenberg v. *Commissioner*, 77 F. (2d) 446 (C. C. A. 8th);
Commissioner v. *Riggs*, 78 F. (2d) 1004 (C. C. A. 3rd);
Commissioner v. *Troup*, 75 F. (2d) 1010 (C. C. A. 7th);

and see

Helvering v. *Johnson*, 104 F. (2d) 140, 143 (C. C. A. 8th);
Commissioner v. *Neaves*, 81 F. (2d) 947, 949 (C. C. A. 9th).

All of these cases held that where property was sold and at the same time a similar amount of the same kind of property was purchased pursuant to a predetermined plan to maintain the taxpayer's position unaltered the substance of the transactions would be looked to rather than the narrow form in which the transactions were placed. In each of these cases it was, therefore, held that the sale would be disregarded and that the purchase and sale treated together would be considered as not altering the taxpayer's status. These cases involve losses claimed by the taxpayers, but in principle this could make no difference.

WHEREFORE petitioner respectfully prays, that the writ of certiorari be granted directed to the United States Cir-

cuit Court of Appeals of the Fifth Circuit to review the judgment herein referred to and that upon said review the judgment be reversed.

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BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

The question involved in this case has been set forth in the foregoing petition for certiorari. It is believed that this question, which is wholly one of law, has been definitely answered by repeated decisions in the Circuit Courts of Appeal in a majority of the Circuits, and that these decisions have, inevitably, followed from controlling decisions of this Court.

However, since none of these cases deal with "switching" transactions in commodity future contracts the decision of the Circuit Court of Appeals in the instant case will establish a precedent in an important field of business transactions, inconsistent with the recognized law governing similar transactions in securities.

Conflicting Decisions of the Circuit Courts of Appeal.

It is submitted that there are a large number of conflicting decisions of the Circuit Courts of Appeal. These decisions follow and accept the principle enumerated in a case arising in the Circuit Court of Appeals, Fifth Circuit, the same Circuit deciding the case at bar. The case referred to is *Esperson* v. *Commissioner,* 49 F. (2d) 259. In this case the taxpayer sold certain securities and at the same time repurchased an equal number of shares of the same stock through another person. The taxpayer claimed that the sale constituted a closed transaction resulting in a deductible loss. The court denied the deductibility of the loss in the following language at page 260:

> "The evidence is set out at length in the above-cited opinions of the Board, and abundantly sustains its conclusion that throughout it was Esperson's intention to keep the same number of shares of stock after the sales were completed that he had before any sales were made. Each share of the stock was of equal value; one

was as good as another. It may be assumed that an owner of stock would sustain a deductible loss by selling it and later buying back an equal amount, but no real sale is made whereby one and the same transaction the same number of shares are both bought and sold at the same price and at the same time."

In the case of *Commissioner of Internal Revenue* v. *Dyer*, 74 F. (2d) 685 (C. C. A. 2nd), the taxpayer sold certain securities and after slightly over thirty days repurchased similar securities. The Court, in denying the deductibility of the loss states, at page 686:

"In the case at bar the inference is inescapable that 'repurchase' of the stock by return of the notes was part of the original plan, and that from the beginning the transferors intended to reacquire their shares in this manner * * * Under these circumstances it is as though there had been an agreement between all the transferors and Elanco that the sale should be coupled with a contract, or, at least an option, to repurchase. The transferors' ownership of their stock was not so completely terminated as to constitute the realization of losses by reason of sales. Compare Esperson *v.* Commissioner, 49 F. (2d) 259 C. C. A. 5). In this aspect, the fact that with respect to the 1927 transaction a profit was reported by Elanco is immaterial."

In the case of *Shoenberg* v. *Commissioner*, 77 F. (2d) 446 (C. C. A. 8th), the taxpayer sold certain shares of stock and at the same time caused a corporation controlled by him to buy an equal number of the same shares of stock. After a period of thirty days the taxpayer repurchased these securities from the controlled corporation. In refusing to permit a deduction of a loss on the sale, the Court stated, at page 449:

"However, where such sale is made as part of a plan whereby substantially identical property is to be reac-

quired and that plan is carried out, the realization of loss is not genuine and substantial; it is not real. This is true because the taxpayer has not actually changed his position and is no poorer than before the sale. The particular sale may be real, but the entire transaction prevents the loss from being actually suffered. Taxation is concerned with realities, and no loss is deductible which is not real."

Other cases accepting and applying the same principle of law are:

Foster v. *Commissioner*, 96 F. (2d) 130 (C. C. A. 2nd);
Commissioner v. *Riggs*, 78 F. (2d) 1004 (C. C. A. 3rd);
Commissioner v. *Troup*, 75 F. (2d) 1010 (C. C. A. 7th);

and see

Helvering v. *Johnson*, 104 F. (2d) 140, at page 143 (C. C. A. 8th);
Commissioner v. *Neaves*, 81 F. (2d) 947, at page 949 (C. C. A. 9th).

There should be noted in connection with these cases the following significant facts:

(1) These cases clearly state that a motive of the taxpayer to reduce his tax liability is not the basis of the decision.

(2) None of the cases come within the provisions of the so-called wash sales section of the Revenue Acts, which Section is 118A of the Revenue Act of 1938, and appears in virtually the same language in every Revenue Act since the Revenue Act of 1921.

(3) The cases are not based on the proposition that no sale took place. They are, rather, based upon the theory that where property is sold with an intention to reacquire substantially the same property that there has been no loss, because, in substance, there has been no change in the eco-

nomic status of the taxpayer. It is submitted that this principle is applicable to the instant case. Here there was no intention to part with the ownership of the property, but, on the contrary, an affirmative intention to retain ownership of the property, and the sales and purchases were made for the purpose of maintaining the same economic status. It happened that because of the rules of the commodity exchanges involved, the only way that ownership could be maintained and the economic status maintained would be a sale with a simultaneous repurchase. Thus, the reacquisition of the substantial equivalent of the property sold was not only in contemplation at the time of the sale, it was of the essence of the sale.

This Principle Has Been Accepted by the Board of Tax Appeals.

The principle of the cases cited above has been accepted and articulated by the Board of Tax Appeals in the following cases:

H. Rodney Sharp, 38 B. T. A. 166, at page 174;
Jos. W. Powell, 34 B. T. A. 655, at page 661;
Pierre S. Dupont, 37 B. T. A. 1198, at page 1266;
Joseph Blumenthal, 30 B. T. A. 125, at page 131.

Conflicting Decisions of This Court.

The underlying rationale of the foregoing cases is the oft repeated judicial maxim that in matters of taxation substance shall prevail over form. That maxim has been often announced and applied by this Court. See, for example, *Griffith* v. *Helvering,* 308 U. S. 355; *Southern Pacific Company* v. *Lowe,* 247 U. S. 330; *United States* v. *Phellis,* 257 U. S. 156; *Gulf Oil Corporation* v. *Lewellyn,* 248 U. S. 71, and *Eisner* v. *Macomber,* 252 U. S. 189.

And cf. *Bowers* v. *Kerbaugh Empire Co.,* 271 U. S. 170.

This maxim has been applied in disregard of apparent transfers where there was no real change in the economic status in the following recent decisions of this Court:

In *Helvering* v. *Clifford,* 309 U. S. 331, this Court held taxable to the grantor the income of an irrevocable term trust on the ground that although a separate trust had been established in form, in fact and reality there had been no real relinquishment of control and ownership.

In the case of *Higgins* v. *Smith,* 308 U. S. 473, this Court held that no deductible loss was incurred by the sale of the property to a controlled corporation on the ground that although a sale had been consummated in form, there was, in reality, no real relinquishment of ownership.

In the case of *Pearson* v. *McGraw,* 308 U. S. 313, there was involved the application of the Oregon Inheritance Tax to a transfer in contemplation of death made by a decedent, a resident of Oregon. Prior to his death decedent had certain bonds and other intangibles in the possession of an Illinois trust company, which was acting as fiscal agent and depository for him. He instructed the Illinois trust company to sell the bonds and purchase Federal Reserve notes. For the purpose of this case the court regarded the Federal Reserve notes purchased by the Illinois trust company as tangible personal property. The decedent thereupon had the Federal Reserve notes transferred to the Illinois trust company, as trustee, to be held in trust, irrevocably for certain members of the decedent's family. Shortly after the establishment of this trust the trustee invested the Federal Reserve notes in bonds and other type of intangible property. The Supreme Court of Oregon and the Supreme Court of the United States accepted as controlling legal principles in the case the proposition that intangible property has a tax situs in the State of residence of the owner, but that tangible property has a tax situs where the property itself was physically located. In accordance there-

with the Supreme Court of Oregon held that since the subject of the gift in trust was the tangible Federal Reserve note, the tax situs thereof was in Illinois and the Oregon Inheritance Tax was not applicable. This Court reversed the ruling holding that the sale of the bonds originally and the investment of the proceeds in Federal Reserve notes, and the later reinvestment of the Federal Reserve notes in intangible property were all steps in one preconceived plan, and the actual result intended and accomplished was the transfer in trust of the originally held intangible property, and, consequently, the tax situs was in Oregon, and the transfer was subject to the Oregon Inheritance Tax. In reaching this result this Court used language which we believe embodies and accepts the argument we have contended for and we quote this statement from pages 317 and 318 of the opinion:

> "On the facts of this case we believe that the various steps in the series must be considered as constituting but one integrated and indivisible transaction—a transfer by decedent of intangibles in contemplation of death. And we reach this result though each step in the series was real and though none was camouflaged or concealed. For basically the sale of intangibles, the acquisition of federal reserve notes, and their transfer under the agreement of August 15, 1935, were interdependent. Cf. Groman *v.* Commissioner of Internal Revenue, 302 U. S. 82; Helvering *v.* Bashford, 302 U. S. 454, 458. From decedent's point of view, completion of the series of steps was necessary for consummation of his program to utilize $450,000 of his estate to provide for certain designated members of his family. Any step short of the final transfer would not have done it. The mere sale of the intangibles and the acquisition of the federal reserve notes had no functional or business significance apart from the August 15, 1935 transfer. That is emphasized here because they created no legal relations and gave rise to no vested rights

interfering with decedent's continuing power of disposition. Taken as isolated transactions, they have meaning and significance only in relation to the third step, a conclusion made especially evident by the close sequence of events. Hence, it is no answer to say that because the first two steps were not irrevocable but could be recalled the third step was not a necessary one in the series. For that is as immaterial as is the revocability of any donor's plan to make a gift in contemplation of death at any moment prior to its consummation. Admittedly decedent had such a purpose on the transfer of the notes. To hold that such purpose was not present on the sale of the intangibles would be to isolate one part of the total transaction and to give it significance and meaning utterly inconsistent with the fact that the intangibles were sold for the purpose of acquiring the notes which, in turn, were to be placed under an irrevocable trust. Therefore we need not consider the nature of federal reserve notes, for in that posture of the case their taxability as such and in isolation from the whole transaction is not in issue."

Substance Should Prevail Over Form.

It is fully realized that the maxim "substance should prevail over form" is a statement of a judicial attitude rather than a rule of law, and as such it can not be automatically and indiscriminately applied to all the various circumstances which can arise in the administration of the Revenue Laws. Nevertheless, it is believed that this maxim through constant application by the Circuit Courts of Appeal to similar situations, has crystalized in to the rule of law here contended for. The decision in the instant case represents a retreat from the constantly extending application of this judicial attitude, and this is unfortunate. Whichever way this case may be decided should not affect the revenue of the Treasury Department. Rather since the wash sales provisions of the Revenue Act do not apply to

commodity transactions, the instant decision would permit the creation of artificial losses by switching transactions undertaken for that very purpose, and, hence, tend to deplete the revenues of the Treasury. But, irrespective of this consideration it can be in the interest of no one to permit the National Tax Laws to be governed by the fortuitous circumstances present in this case, or the artificial technicalities of legal form. Wherever economic substance conflicts with legal formality it should be the inclination of all concerned to follow the path of reality.

Because the present decision conflicts with this rule; and because it presents a conflict in principle with other circuits; and because there should be as little confusion as possible in our tax laws, the writ should be granted in this case.

Respectfully submitted,

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On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

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REPLY BRIEF FOR PETITIONER.

The response to the petition for certiorari, when analyzed, is in reality an appeal to the Court to do what the Circuit Court of Appeals did, namely, to dispose of the case by a narrow regard for the form which the transactions took, and with a complete disregard of the real substance of the matter.

This is shown by the Government's argument—its only argument—that taxpayer's position was changed by reason of these switching transactions because, the Government says,

the switching transactions made cash available to the taxpayer which had not been otherwise available. To sustain this the Government says that in each switching transaction, when the cotton was sold a credit to the taxpayer was entered on the books of the broker, subject to be withdrawn by it, and a new cotton purchase account was opened. There could be no more complete illustration than this of a narrow regard for form rather than substance. It reaches a climax when the Government says that before the switching transactions the taxpayer had cotton, and after the transactions the taxpayer had cotton and cash. This may be the way the matter appears from the standpoint of form; it is in no sense, however, the real substance of the situation.

Methods of trading in commodities for future delivery on established exchanges are so much a part of our economic life that they are undoubtedly within the judicial cognizance of the Court. Let us, therefore, state exactly what would occur, so far as available cash is concerned, in any such transactions. It is very simple, namely:

When the taxpayer entered into a contract for cotton the broker would buy the cotton, debit the taxpayer's account with the purchase price and credit the account with the amount put up as margin. The contract for the cotton would remain in the broker's name. If the cotton advanced in value the amount that the taxpayer could withdraw from the account in cash would depend wholly upon the extent to which the increased value of the cotton exceeded the required margins. Thus at the time of a switching transaction, when cotton had advanced in price the taxpayer would have a withdrawable amount of cash in the account. Now the switching transaction would not increase this amount of withdrawable cash at all. When the cotton was sold the taxpayer's account would be credited with the profit, a new debit would be made for the new purchase, which new debit obviously would be greater than the debit on the previous purchase by the exact

amount that cotton had increased in price; and this increase in the debit being thus based on the increased price of cotton, would be the exact equivalent of the credit given the taxpayer as a profit on the first purchase of cotton. Thus the net balance in the taxpayer's account (the new debit less the new credit) would be equal to the old debit before the switching transaction. The net status of the taxpayer's account would, therefore, be that he would have the same amount of the same kind of cotton, subject to the same net debit. He would be allowed to withdraw from the broker exactly the same amount of cash that he could have withdrawn before the switching transaction.

So long as any one dealing through a broker (stocks and commodities are here exactly alike) maintains an unchanged long position, his margin requirements, except for market fluctuations, will be the same. Any withdrawals of cash by him from the broker, with the long position unchanged, amount to nothing but advances by the broker against the increased value in his account.

Now in the instant case it makes no difference as to what method was taken in writing up these things on the books. The whole transaction could be combined in one account, or it could be separated into two accounts, which the broker set up or which the taxpayer set up. The net effect of the book-keeping taken as a whole would be exactly what we have stated. The substance of the transaction would be that the taxpayer's position remained unchanged. The proof is clear that it was intended to be unchanged; that the purchase and sale constituting a switching transaction were not intended to be separate transactions but part of one transaction to carry out a pre-determined plan to retain an unchanged position.

It thus appears clear that the statement in our petition for certiorari is completely confirmed by the Government's re-

sponse, namely: This case turns entirely on whether, in the particular matters, tax liability is to be determined by form or substance. The case, therefore, presents a wide departure from the established principle of this Court that substance should control in such matters. Such a departure is a matter of general importance. It should not be permitted to enter into our tax laws unless this Court is willing to give it its sanction. Even aside from the fact that commodity dealings of this character are very widespread in the country, the question is one inherently of sufficient importance to justify the grant of the writ.

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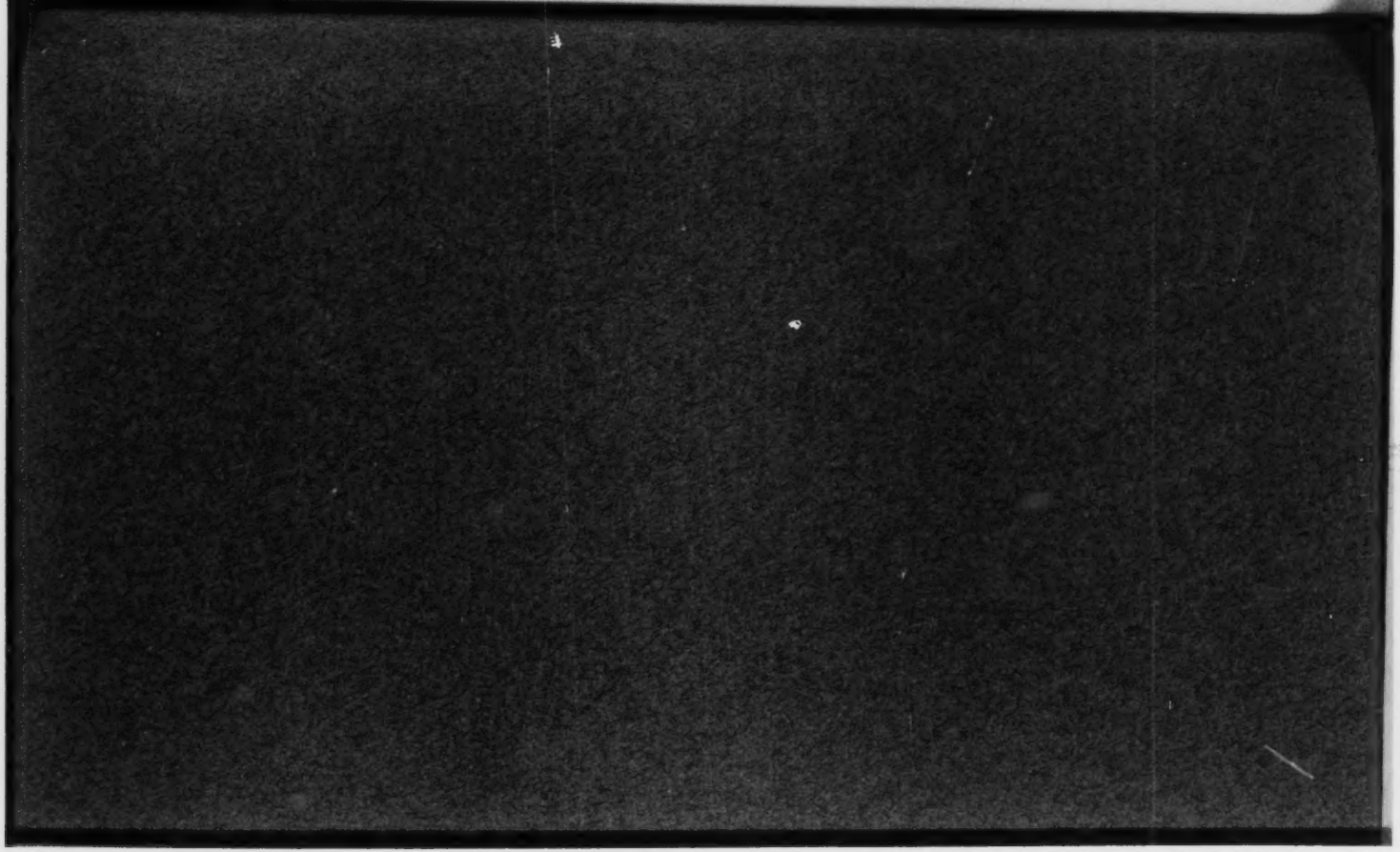
ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION



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282869—41

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 614

VALLEY WASTE MILLS, PETITIONER

v.

W. E. PAGE, JR., AND FIRST NATIONAL BANK OF ATLANTA, EXECUTORS OF THE ESTATE OF W. E. PAGE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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OPINION BELOW

The District Court's findings of fact (R. 20) and conclusions of law (R. 27) are not officially reported. The opinion of the Circuit Court of Appeals (R. 30) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 7, 1940 (R. 35). The petition for a writ of certiorari was filed December 10, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A corporation during the taxable year disposed of cotton contracts calling for the future delivery of cotton during that year and was credited on the books of its brokers with the profits resulting from such dispositions. Simultaneously, it acquired contracts calling for later future delivery of the same quantity of cotton. The question is whether the profits credited to the taxpayer constitute realized gain for income tax purposes?

STATUTE INVOLVED

The pertinent provisions of the statute involved are set forth in the Appendix, *infra*, pp. 10–12.

STATEMENT

The relevant facts, as stipulated (R. 13–20) and as found by the District Court (R. 20–27), may be summarized as follows:

The taxpayer, a Georgia corporation, after filing with the Commissioner its claim for refund, which was denied, brought this suit to recover income taxes and interest alleged to have been illegally collected by W. E. Page, then a Collector of Internal Revenue (R. 21). The respondents are executors of Page's estate (R. 21).

On January 1, 1933, taxpayer owned contracts on the New York and New Orleans Cotton Exchanges calling for the future delivery of 10,500 bales of cotton (R. 21). All contracts on those cotton exchanges covering cotton purchased for

future delivery provide for delivery in less than twelve months from the date of purchase (R. 22).

The board of directors of taxpayer, prior to January 1, 1933, ordered that taxpayer's long or buyer's position be maintained in the cotton market to the extent of the quantity of cotton represented in the contracts owned January 1, 1933 (R. 22). The only way under the rules of the New York and New Orleans Cotton Exchanges in which taxpayer as owner of the cotton contracts could uninterruptedly maintain its long position over a period of time was to sell the cotton contracts calling for future delivery prior to the delivery date thereof and, simultaneously with the sale, buy cotton contracts calling for the future delivery of a like amount of cotton in a subsequent month (R. 22).

The taxpayer did maintain its long position in the cotton market by selling the cotton contracts prior to their delivery date and, simultaneously, buying new contracts calling for the same amount of cotton to be delivered in the future (R. 22). The profit or loss resulting from each sale, together with the expenses attending the sale, and simultaneous purchases, were reflected on the books of the cotton brokers through whom taxpayer traded (R. 22). The books of the taxpayer for the year 1933 also reflected such profit or loss resulting from the sale of each contract (R. 23). Whether all or any part of the credit balance could be withdrawn would depend on whether and to what extent it was

needed to meet margin requirements for the account (R. 22). No part of taxpayer's long position in cotton was liquidated until subsequent to the year 1933, and then by order of its board of directors (R. 22–23).

The Treasury Department, in computing the tax liability of taxpayer for the year 1933, ruled that each time a contract for the delivery of cotton in a particular month was sold, such sale constituted a closed transaction, and taxable gain or deductible loss resulted therefrom, despite the fact that simultaneously with such sale taxpayer purchased a cotton contract calling for the future delivery of the same quantity of cotton just sold (R. 22–23). It thereupon added to taxpayer's taxable income for that year the amount by which the gains exceeded the losses from the sales of the contracts (R. 23).

Taxpayer has been engaged in buying and selling cotton waste or re-worked cotton. In the year 1933 the board of directors of taxpayer ordered that active business of taxpayer be discontinued, except to fulfill contracts which had been made and to dispose of the inventories on hand; and further, that contracts for future deliveries of cotton be purchased to cover the amounts of waste so sold, and that its buyer's position so established by the purchases of such cotton futures contracts be maintained in addition to its buyer's position established by its prior purchases of cotton futures contracts. Pursuant to this action, as waste was sold, con-

tracts for the future delivery of 2,100 bales of cotton were purchased in the year 1933, and the extent of its buyer's position established by such purchases was maintained in the manner stated (R. 23).

It was stipulated orally at the trial that "With respect to each lot of cotton carried under the transactions involved, the plaintiff finally closed out the lot (treating the switching from one month's delivery to a later delivery as not a closing out) at a net loss on the transaction" (R. 24).

The District Court concluded (R. 28) that under the taxing Act each sale in this case was a closed transaction, and that the taxpayer was not entitled to recover. The Circuit Court of Appeals affirmed (R. 30–35).

ARGUMENT

The sales of cotton contracts at more than cost gave taxpayer a credit balance on its brokers' books subject to its immediate withdrawal except to the extent needed to meet margin requirements (R. 22). There is no evidence showing what the margin requirements, if any, were at various times and, so far as is known, taxpayer may have withdrawn its profits in whole or in part in the form of cash. The sole question is whether the profits thus subject to the control of taxpayer may be included in its taxable income. The only reason advanced for exempting these profits from taxation is that taxpayer, pursuant to a predetermined plan,

simultaneously purchased other contracts calling for a like amount of cotton. It is urged that there was no change in taxpayer's economic position and therefore no *realization* of gain (Pet. 4, 5–7).[1] Neither the premise nor the conclusion of the argument is sound.

1. As a matter of fact there was a very decided change in taxpayer's economic position—one in no way comparable to a mere postponement of the delivery date of the contracts. The taxpayer in the case at bar started with a contract for cotton deliverable at a certain date and ended with a contract for cotton deliverable at a different date, together with cash or its equivalent. It may, so far as the record shows, have taken that cash and spent it. One who merely postponed the delivery date of the contracts would not *realize* upon any increase in their economic worth and, of course, would not receive cash or its equivalent during the taxable year as taxpayer did in this case.

2. The closest analogies fully support the decision below taxing these profits. It is settled that a gain may be "realized" by a taxpayer upon a mere change in the nature of the legal rights held though there has been no addition to his economic worth. *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 225, and cases cited. Here there was not only an increase in the economic worth of the contracts

[1] No contention is made that the gain, if *realized*, should not be *recognized* under Section 112 of the Act.

but the increase was made available to taxpayer in the form of cash.

Whether taxpayer chose to enjoy its profits, as it may have done, or to leave them with its broker as margin for other commitments, in either case the profits are equally subject to the income tax. *Webb* v. *Commissioner,* 67 F. (2d) 859 (C. C. A. 2d); *Baker* v. *Commissioner,* 81 F. (2d) 741 (C. C. A. 3d); *Foley* v. *Commissioner,* 94 F. (2d) 958, 962–963 (C. C. A. 3d), certiorari denied, 305 U. S. 615; *Sachs* v. *Commissioner,* 111 F. (2d) 648 (C. C. A. 6th); *Burrows* v. *Commissioner,* 38 B. T. A. 236. Compare *Corliss* v. *Bowers,* 281 U. S. 376. And the fact that in a later year the taxpayer may have closed out its holdings at a loss greater in extent than its profits during the year in question is wholly without significance. Such a result is a frequent and inescapable consequence of laying income taxes upon a taxpayer's operations during a twelve month statutory accounting period. *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359, 364. We submit that there is no merit to the taxpayer's contentions.

3. The taxpayer cites no case concerning cotton futures contracts or trading in marginal accounts. It is believed that, despite the asserted frequency of such transactions (Pet. 5–6), there are no decisions supporting taxpayer's position.

Various cases are cited (Pet. 6) for the proposition that in tax matters substance and not form

should prevail. There is a short answer to the contention based upon those decisions. The substance of the transactions in question is that taxpayer's cotton contracts, which had increased in value, were sold in a manner permitting the increase to be received by taxpayer in cash or its equivalent.

The remaining cases cited (Pet. 7) involve claimed deductions for losses on the sales of stock where efforts were made to circumvent the wash-sale provisions of the revenue acts or where the taxpayer retained an interest in or control over the property in form sold. The issue in those cases was whether the taxpayer could take a deduction for a loss where it had not definitively disposed of the property. Here, quite a distinct issue arises—whether an admitted profit which was reduced to cash during the taxable year is subject to income tax in the hands of taxpayer. Compare *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415, with *Higgins* v. *Smith,* 308 U. S. 473.

CONCLUSION

The judgment of the court below is plainly correct. There is no conflict of decisions, and no question of general importance is presented. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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JANUARY 1941.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from * * * commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

(1) PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT.—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) STOCK FOR STOCK OF SAME CORPORATION.—* * *

(3) STOCK FOR STOCK ON REORGANIZATION.—* * *

(4) SAME—GAIN OF CORPORATION.—* * *

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—* * *

(c) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

* * * * *

SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES.

(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

* * * * *

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